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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 109.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

NATIONAL INDUSTRIAL ALCOHOL COMPANY, INC.,
Respondent.

On Writ of Certiorari to the Court of Appeals of the District of Columbia.

BRIEF FOR RESPONDENT.

R. M. O'HARA,
Counsel for Respondent.

January, 1931.

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NATIONAL INDUSTRIAL ALCOHOL COMPANY, INC.,
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On Writ of Certiorari to the Court of Appeals of the District of Columbia.

BRIEF FOR RESPONDENT.

This case comes before the Court on a Writ of Certiorari granted June 2, 1930, and involves a proceeding instituted by respondent before the United States Board of Tax Appeals. The determination of the Board of Tax Appeals was reversed in part by the Court of Appeals of the District of Columbia, following which petitioner applied for and was granted a Writ of Certiorari.

OPINIONS BELOW.

Court of Appeals of the District of Columbia, Opinion, 38 Fed. (2nd) 718.

United States Board of Tax Appeals, Opinion, 7 B. T. A. 1241.

QUESTION PRESENTED.

Did Congress intend by Section 234 (a) (4) of the Revenue Act of 1918 to authorize as a deduction a loss sustained on the abandonment of tangible assets which had become valueless through prohibition legislation?

STATUTE INVOLVED.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077:

> "Sec. 234 (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions: • • •
>
> "(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; • • •"

STATEMENT.

Respondent adopts the statement of the case as set forth on pages 3 to 6 of petitioner's brief, with the addition of the following:

Respondent in both the petition to the Board of Tax Appeals and the petition to the Court of Appeals of the District of Columbia made alternative claims for the deduction on account of abandonment of its building, claiming either under Section 234 (a) (4) as a loss sustained during the taxable year and not

compensated for, or under Section 234 (a) (7) as obsolescence. (R. 4, 13.)

The Board of Tax Appeals refused to permit the deduction under either subsection. (R. 10.)

The Court of Appeals held that the loss was deductible but did not specify the subsection of the Revenue Act under which deductible. (R. 27.)

In this proceeding respondent elects to have its right to a deduction determined under Section 234 (a) (4) of the Revenue Act of 1918 as a loss sustained within the taxable year ended May 31, 1920, and not compensated for by insurance or otherwise.

The following facts do not appear in the record, but respondent requests that the Court take judicial notice of them.

The Joint Resolution proposing the Eighteenth Amendment to the Constitution was adopted by both houses of Congress in December, 1917. It became a part of the Constitution on January 16, 1919, although it did not become effective by its terms until a year later. The Revenue Act of 1918 was enacted into law on February 24, 1919.

SUMMARY OF ARGUMENT.

The Sixteenth Amendment to the Constitution granted to the Congress the power to collect taxes on incomes from whatever source derived, without apportionment between the States. The legislative history of the taxing statutes shows that in all Revenue Acts, including the Revenue Act of 1918, Congress specifically enumerated those classes of income not subject to tax and those items not deductible in arriving at taxable income. The Treasury Department construed the Revenue Act of 1918 as permitting

deductions representing losses sustained because of national prohibition. In neither the Revenue Act of 1918 nor in any subsequent Revenue Act did Congress include among the items not deductible losses sustained by reason of constitutional prohibition. It must therefore be presumed that the intent of Congress was to permit the deduction of such losses.

Section 234 (a) (4) of the Revenue Act of 1918 provides that there shall be allowed as deductions losses sustained during the taxable year, without in any manner whatsoever qualifying the word "losses." Under the construction given to taxing statutes by the courts, it must be presumed that Congress intended to permit the deduction of losses growing out of prohibition legislation.

ARGUMENT.

Point 1.

The legislative history of the various taxing statutes enacted by Congress under the power conferred on it by the Sixteenth Amendment to the Constitution shows that Congress in enacting the Revenue Act of 1918 did not intend to exclude from allowable deductions losses sustained as a result of prohibition legislation.

The Sixteenth Amendment to the Constitution provides that "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

In the early acts enacted by Congress under the authority of this amendment it was expressly provided what classes of income should not be subjected to tax, and what items should not be allowed as deductions.

> Act of October 3, 1913, (Revenue Act of 1913), Section B. (c. 16, 38 Stat. 166.)
>
> Act of September 8, 1916, (Revenue Act of 1916), Title I, Part II, Sections 4, 5, 11 and 12. (c. 463, 39 Stat. 756.)
>
> Act of October 3, 1917, (Revenue Act of 1917), Title I, Sections 3 and 4. (c. 63, 40 Stat. 300.)

On January 16, 1919, the Eighteenth Amendment became a part of the Constitution, prohibiting the manufacture, sale or transportation of intoxicating liquors. On February 24, 1919, or thirty-nine days thereafter, there was enacted into law a new Revenue Act known as the Revenue Act of 1918. (c. 18, Title II, 40 Stat. 1057.) It is under Section 234 (a) (4) of the Revenue Act of 1918 that the loss here in question is claimed.

Following the legislative precedent established in the enactment of the three prior Revenue Acts, Congress, in the Revenue Act of 1918, again made specific provision as to those classes of income not subject to tax and those items not deductible. Section 213 of the Act defined gross income in the case of an individual, and in subsection (b) thereof enumerated those specific classes of income not subject to tax. Section 233 defined gross income in the case of a corporation and provided that gross income meant the gross income as defined in Section 213 ex-

cept for certain other and additional classes of income not subject to tax.

Section 214 provided what deductions should be allowed to an individual in computing net income, and Section 215 listed those items not deductible in the following language:

> "SEC. 215. That in computing net income no deduction shall in any case be allowed in respect of—
>
> "(a) Personal, living, or family expenses;
>
> "(b) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;
>
> "(c) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or
>
> "(d) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy."

The list of items not deductible under the Statute did not include losses resulting from prohibition legislation.

Section 234 of the Act enumerated those deductions which should be allowed in computing the net income of a corporation; and Section 235, instead of listing those items not deductible to a corporation, referred back to Section 215 and provided:

> "That in computing net income no deduction shall in any case be allowed in respect of any of the items specified in Section 215."

It should be noted that the Revenue Act of 1918, which mentions specifically those items not deductible but did not include therein losses from prohibition legislation, was enacted thirty-nine days after the Eighteenth Amendment had become a part of the Constitution.

Early in the administration of the Revenue Act of 1918 the Treasury Department was called upon to pass on the deductibility of losses to brewers and distillers resulting from prohibition legislation; and, construing the Act as justifying the deduction of such losses, the Department in 1919 promulgated Article 143 of Regulations 45, providing in part as follows:

> "ART. 143. Loss of useful value.—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, *or where new legislation directly or indirectly makes the continued profitable use of the property impossible.* * * *" (Italics ours)

This article has been retained practically without change in regulations promulgated under all of the subsequent Revenue Acts.

Article 143, Regulations 62 (promulgated in 1922) Revenue Act of 1921.
Article 143, Regulations 65 (promulgated in 1924) Revenue Act of 1924.
Article 143, Regulations 69 (promulgated in 1926) Revenue Act of 1926.
Article 173, Regulations 74 (promulgated in 1929) Revenue Act of 1928.

From 1919 until the decision of this Court in Clarke v. Haberle Crystal Springs Brewing Company (280 U. S. 384), the Treasury Department construed the Revenue Act of 1918 as permitting the deduction of losses resulting from prohibition legislation. That construction of the Department was affirmed by the United States Board of Tax Appeals and the Courts.

In early rulings the Treasury Department approved in principle the deductibility of such losses, even as extended to intangibles, and prescribed rules for the computation of the loss and the method of charging it against income. Illustrative of such rulings are the following:

T. B. R. 44, 1 C. B. 133. (promulgated in 1919)
L. O. 862, 1 C. B. 127. (promulgated in 1919)
A. R. M. 34, 2 C. B. 31. (promulgated in 1920)

In various specific instances the Treasury Department, the Board of Tax Appeals and the Courts have allowed deductions for losses resulting from prohibition legislation, in the year in which the property was abandoned.

O. D. 125, 1 C. B. 133. (promulgated in 1919)
A. R. R. 6349, III-1 C. B. 148. (promulgated in 1923)
Appeal of Zakon, 7 B. T. A. 687. (decided in July, 1927)
McAvoy Company v. Commissioner, 10 B. T. A. 1017. (decided in February, 1928)
Sheffield Dentifrice Company v. Commissioner, 13 B. T. A. 877. (decided in October, 1928)
Dean v. Hoffheimer Brothers Company, 29 Fed. (2nd) 668. (decided in December, 1928)

After the Treasury Department had construed the Revenue Act of 1918 as permitting such deductions, and after that construction had been approved by the Board of Tax Appeals, Congress enacted new Revenue Acts known respectively as the Revenue Acts of 1921, 1924, 1926 and 1928. In all of those later Revenue Acts, Congress followed the precedent theretofore established, enumerating specifically those items not deductible; but in the case of no one of those later Revenue Acts did it include among those items not deductible, losses sustained as a result of prohibition legislation.

Act of November 23, 1921 (Revenue Act of 1921), Title II, Sections 215 and 235 (c. 136, 42 Stat. 227).
Act of June 2, 1924 (Revenue Act of 1924), Title II, Sections 215 and 235 (c. 234, 43 Stat. 253).
Act of February 26, 1926 (Revenue Act of 1926), Title II, Sections 215 and 235 (c. 27, 44 Stat. 9).
Act of May 29, 1928 (Revenue Act of 1928), Title I, Section 24 (c. 852, 45 Stat. 791).

The foregoing legislative history of income tax legislation and of the construction of the 1918 Act

by the Treasury Department and the Board of Tax Appeals, precludes a finding that Congress intended to exclude from the class of allowable deductions, losses sustained from prohibition legislation.

> In Section 234 of the Revenue Act of 1918, Congress provided for certain deductions from the gross income of corporations, and included "losses sustained during the taxable year and not compensated for by insurance or otherwise"; it also, in Sections 215 and 235 of that Act, mentioned specifically those items which did not constitute deductions.
>
> The Treasury Department, prior to the enactment of the next succeeding Revenue Act (Revenue Act of 1921) construed those sections of the Revenue Act of 1918 as permitting a deduction for losses sustained as a result of prohibition legislation, and held to that construction until the decision of this Court in Clarke v. Haberle Crystal Springs Brewing Company, *supra*. That construction was approved by the Board of Tax Appeals and the Federal Courts.
>
> In all of the subsequent Revenue Acts, namely, the Revenue Acts of 1921, 1924, 1926 and 1928, Congress reenacted practically without change those provisions covering deductions contained in Sections 234, 215 and 235 of the Revenue Act of 1918.

The reenactment by Congress in the later Revenue Acts without substantial change of those sections of the Revenue Act of 1918 which had continuously been construed by the executive department as permitting a deduction for a loss such as in the case at bar is an adoption by Congress of such a construction. (U. S. v. Falk, 204 U. S. 143; U. S. v. Cerecedo *et al.*, 209 U. S. 337; National Lead Company v. U. S., 252 U. S. 140)

Point 2.

The broad language of Section 234 (a) (4) of the Revenue Act of 1918 permits the deduction of losses sustained by reason of national prohibition legislation.

Section 234 (a) (4) of the Revenue Act of 1918 provides that there shall be allowed as deductions

> "losses sustained during the taxable year and not compensated for by insurance or otherwise"

Neither in the Revenue Act of 1918 nor in any subsequent act did Congress provide specifically that losses sustained through prohibition legislation were not deductible. Such losses, therefore, are deductible unless they do not fall within the deductions provided for by Section 234 (a) (4).

The language of the statute, so far as it concerns the word "losses" is without any qualification or restriction. The only requirement as a prerequistie to the deduction is that the losses be (1) sustained during the taxable year, and (2) not compensated for by insurance or otherwise.

This Court has said, in construing the word "property" found in Section 12 (a) of the Revenue Act of 1916,

> "There is nothing to suggest that the word 'property' is used in any restricted sense." Lynch v. Alworth-Stephens Company, 267 U. S. 364.

What was said by this Court in that case with respect to the word "property" is equally applicable here with respect to the word "losses" as it appears in Section 234 (a) (4).

The use of the word "losses" in Section 234 (a)

(4) without restriction, limitation or qualification, leaves no room for doubt as to the intent of Congress in providing for the deduction of all losses except those specifically enumerated as not deductible. It is not therefore necessary to invoke the rule established by this Court that in the case of taxing statutes any doubt which exists as to the intent of Congress should be resolved against the Government and in favor of the taxpayer. Gould v. Gould, 245 U. S. 151; U. S. v. Wigglesworth, 2 Story 369; Benziger v. U. S., 192 U. S. 38; American Net and Twine Company v. Worthington, 141 U. S. 468.

CONCLUSION.

The loss claimed by respondent was sustained on the abandonment of its property on November 3, 1919, during the fiscal year ended May 31, 1920, and was not compensated for by insurance or otherwise. The statute specifically enumerates those items not deductible, and such enumeration does not mention losses sustained through prohibition legislation. In defining losses that are deductible the statute provides without restriction for the deduction of losses sustained during the taxable year and not compensated for by insurance or otherwise.

The decision of the Court of Appeals of the District of Columbia should be affirmed, and there should be allowed to respondent as a deduction from income in the taxable year ended May 31, 1920, the loss sustained by it through the abandonment of its tangible property as a result of prohibition legislation.

Respectfully submitted,

R. M. O'Hara,
Counsel for Respondent.

January, 1931.